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No. 90

Legislative Notice

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S. 1301 — Consumer Bankruptcy Reform Act

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Reported from the Committee on the Judiciary on June 4 with an amendment in the nature of a substitute. All 10 Republicans on the Committee and 5 Democrats (Leahy, Biden, Kohl, Durbin, Torricelli) voted to report the bill favorably; 2 Democrats voted "no". S. Rept. No. 105-253, together with Additional and Minority Views.

NOTEWORTHY

- The Majority Leader is expected to bring S. 1301 to the floor soon. The first vote in relation to the bill may be on a motion to invoke cloture.
- Nearly everyone agrees that the bankruptcy system is in need of reform. S. 1301 has bipartisan support: Senators Grassley and Durbin introduced the original bill and, as noted above, the bill was reported from Committee with broad bipartisan support. The Administration has stated its support for reform but has not yet stated its position on S. 1301.
- The House of Representatives passed its own bankruptcy bill (H.R. 3150) on June 10 (now pending on the Senate Calendar). The vote in the House was 306-to-118; 222 Republicans and 84 Democrats voted for the bill. The Administration strongly opposed the House bill, however.
- A key reform in S. 1301 is "means-testing." Under the bill, a bankruptcy court may dismiss a claim for relief if it finds that granting relief would be an "abuse" of the bankruptcy laws, and one of the facts tending to show abuse is current income of the debtor that is sufficient to pay at least 20 percent of the unsecured claims against him.
- S. 1301 "contains several important reforms which will protect individuals who face unnecessary and unfair harassment from creditors." [S. Rept. at 26]
- The bill aids child support claimants in bankruptcy proceedings.

HIGHLIGHTS

The Constitution gives Congress express power "To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." Art. I, §8, cl. 4. Bankruptcy laws have been a permanent part of the federal code for 100 years.

Needs-Based Bankruptcy

Under current law, individuals considering bankruptcy generally proceed under Chapter 7 or Chapter 13. Under Chapter 7 (which is what most people think of when they think of *bankruptcy*), the debtor surrenders those assets which do not qualify for an exemption under the law, and the assets are sold to satisfy (in part) the demands of the creditors. Any deficiency which remains after the sale of the assets is erased (the law calls it "discharged"). Chapter 13, on the other hand, provides for the development of a repayment plan to repay a portion of the debtor's debts using future earnings. When the debtor has made his payments as required under the repayment plan, any unpaid portion of his debt is discharged. There are about five filings under Chapter 7 for every two filings under Chapter 13.

Prior to 1984, an individual contemplating bankruptcy could freely choose between Chapter 7 and Chapter 13. However, in an effort to address concerns about misuse of Chapter 7 by those with the means to repay some of their debts, Congress amended the bankruptcy code in 1984 so that a Chapter 7 bankruptcy case could be dismissed if there was "substantial abuse" of the law. However, only the judge or the bankruptcy trustee, not a creditor, could make a motion alleging "substantial abuse." For various reasons, the 1984 amendment has failed to have the hoped-for effect, and S. 1301 addresses the issue again.

S. 1301 allows a bankruptcy judge to dismiss a Chapter 7 case (or convert it into a Chapter 13 case if the petitioner consents) if the system is being "abused" (*not* "substantially abused" as under current law). A motion alleging abuse of the system can be filed by the trustee, by the court on its own motion, or (unlike current law) by any party in interest. In considering whether there has been abuse of the system, the court is to consider (1) whether the bankruptcy petition was filed in bad faith, and (2) whether the debtor, based on his current income, can repay at least 20 percent of his general unsecured debts. (The Report notes, on page 24, that the Department of Justice wrote the Committee on May 7, 1998, to say that it supports a "judicially administered means-test.")

The House bill (H.R. 3150) is similar to the Senate bill but does not allow the judge discretion. Under section 103 of the House bill, the court "shall dismiss" a case if granting relief "would be an inappropriate use" of the bankruptcy law.

S. 1301 gives bankruptcy trustees important new financial incentives for ferreting out potential debtors who would be able to repay their debts (or some portions of their debts). The bill also

provides penalties for bankruptcy attorneys who recklessly steer individuals toward Chapter 7 even when those individuals have the capacity to repay their debts.

Better Protection for Consumers

S. 1301 contains several important reforms which will protect individuals from unfair harassment by creditors. For example, section 203 targets the problem of coercive re-affirmations of debts by providing that creditors who do not comply with the pro-consumer provisions in section 524 of the bankruptcy code will face treble damages and other fines and costs. Section 203 also bars creditors from using certain collection techniques if they refused to accept an offer of compromise from a financially troubled customer who later declares bankruptcy.

The bill also contains numerous other protections for consumers (these are summarized on pages 36-37 of the Report). Additionally, the Committee adopted a Durbin amendment to protect the elderly from predatory, high-cost mortgage loans.

Better Protections for Child Support

"In response to concerns that certain provisions of S. 1301 could have unintended consequences which would make the collection of child support debts more difficult, the Committee unanimously accepted an amendment offered by Senators Hatch, Grassley and Kyl to enhance the relative position of child support claimants in bankruptcy proceedings. Section 325 of S. 1301 now requires the payment of all unpaid child support prior to other debts in a Chapter 7 liquidation proceeding and prior [to a final discharge] in a Chapter 13 bankruptcy. Similarly, Section 325 requires child support to be paid first before other priority debts in a Chapter 13 repayment plan." [S. Rept. at 28]

Reducing Other Abuses

Many of the worst abuses in the bankruptcy system are committed by individuals who repeatedly file for bankruptcy. Accordingly, Title III of S. 1301 contains restrictions on repeat filers. Title III also requires random audits of bankruptcy petitions to verify the accuracy of the information provided. The bill also redefines non-dischargeable debts to include debts that are incurred as a result of a civil judgment relating to sexual misconduct or violent conduct.

S. 1301 authorizes 18 new temporary bankruptcy judgeships around the country and extends five other judgeships.

BACKGROUND

In calendar year 1997, there were more than 1.3 million consumer filings for bankruptcy (and another 54,000 filings by businesses). S. 1301 is motivated in part by the explosion in consumer bankruptcies, which is especially troubling when the economy is relatively healthy.

**Nonbusiness Bankruptcy Cases Commenced in U.S. Bankruptcy Courts,
Selected Calendar Years**

1947	15,574
1957	63,617
1967	191,729
1977	182,210
1987	495,553
1997	1,350,118

There is a growing sense that the bankruptcy law itself is responsible in part for the explosion in personal bankruptcies. The law itself may be reinforcing a new and unhealthy attitude toward bankruptcy. Lloyd Bentsen, former Chairman of the Senate Finance Committee and former Secretary of the Treasury, explained the new problem in these words:

"To a growing number of middle class and fairly wealthy Americans, it is perfectly acceptable to treat bankruptcy as a financial planning tool, and to expect others to pay the price for debts that they choose not to honor — even if these obligations can reasonably be repaid over time. While there is nothing wrong in legitimately admitting financial defeat by filing bankruptcy when one cannot repay debts, many people seem to be losing the justifiable sense of embarrassment Americans once felt in asking others to shoulder their burden." [*The Washington Times*, 9/19/97] [See also, the sources cited on page 24 of the Committee's report.]

Other observers think the explosion in bankruptcies has less to do with a change in morals than with changes in money management. Committee Democrats say, "Studies prepared by [CBO] indicate that personal bankruptcy filings increase almost in lockstep with increases in household debt-to-income ratios," and, "In 1975, total household debt was 24 percent of aggregate household income [while today] household debt is more than 100 percent of aggregate household income." [S. Rept. at 70, 69] In turn, the debt that households are incurring is being prompted and driven by aggressive marketing of credit cards and other forms of debt:

"More than two and a half billion card solicitations were mailed every year between 1994 and 1996. This means more than 41 mailings went out each year to every American household — not counting telephone solicitations [which amounted to some 24 million telemarketing hours in 1996]. Based on industry estimates, those offers add up to about \$243,000 of credit per household per year. At this rate, in a little over four years, the credit card companies have offered about a million dollars of credit to every household in the United States." [Quoted at S. Rept. p. 95]

The Judiciary Committee has "strong reservations" about restricting the availability of credit, which is what some opponents of S. 1301 desire. Supporters instead suggest that, "if credit lending practices are restricted as the dissenters suggest should be, the result will be less

credit available to women, minorities, and others who need to borrow money. . . ." [S. Rept. at 24] Accordingly, S. 1301 provides the necessary balance, addressing both the consumer side of the problem and the corporate side of the problem. "[T]he Committee recommends S. 1301, which will promote fair and balanced reforms of the consumer bankruptcy laws while providing an unprecedented level of protection for all consumers, especially ex-spouses, single parents, and children affected by bankruptcy proceedings." [S. Rept. at 22-23]

ADMINISTRATION POSITION

No Statement of Administration Policy (SAP) was available at press time. In June, the Administration issued a SAP "strongly oppos[ing]" the House bill (H.R. 3150) but agreeing that the bankruptcy system needs reform to "require responsibility of debtors who have the ability to repay a portion of their debts" and to "prevent abuse of the bankruptcy system by all relevant parties."

COST

Private Sector. New mandates on the private sector are expected to run into the hundreds of millions of dollars (\$200 million to \$525 million in 1999; \$300 million to \$950 million in 2003). Nearly all of these costs arise from a requirement that attorneys who handle consumer bankruptcies investigate and verify the financial information that is provided by their clients. These costs will be borne initially by the attorneys, but most of the costs will then be covered by the bankruptcy estate. Such administrative costs get priority treatment in the bankruptcy system; the attorneys will be paid before most creditors.

Federal Government. CBO estimates that enactment of S. 1301 would cost \$293 million for fiscal years 1999 through 2003. About 95 percent of this amount would be discretionary spending subject to appropriation of necessary funds. The majority of the new costs are attributable to the bill's requirement (in section 321) that bankruptcy trustees establish training programs to educate debtors on financial management.

State & Local Governments. S. 1301 contains no intergovernmental mandates and would have no significant impact on the budgets of State and local governments.

OTHER VIEWS

Seven of the eight Democrats on the Committee signed additional or minority views. Five of the seven support the bill. In their Minority and Dissenting Views, Senators Kennedy and Feingold say, "Clearly, steps must be taken to reign in the number of individuals and families filing for bankruptcy[,] but this bill is "not a well-balanced solution" and the bill "has the potential to harm women and children, the elderly, and the unemployed."

POSSIBLE AMENDMENTS

At the time of publication, there were no printed amendments to S. 1301 and no other amendments were known to us. However, the Minority and Dissenting Views of Senators Kennedy and Feingold contain five areas where they believe the bill needs amending. [S. Rept. at 98] Also, there are several rumors about extraneous amendments being offered to S. 1301.

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